Second, the ILECs' rate of return has never been guaranteed. A regulated return reflects the maximum a public utility may lawfully earn, but it has always been up to the management of the public utility to run the business so that the company actually earns a return on its investment.[87] The situation should be no different in a competitive environment.

Third, local telephone companies have in fact been enormously profitable over the past decade. Price cap regulation at the state and federal levels has granted ILECs unprecedented opportunities to retain high returns on capital investments. Further, as the ILECs have so often stated, price cap regulation has given the telephone companies the incentive to become more efficient, thus preparing them for competition.

Further, there is no evidence that historical or stranded ILEC costs are due to competitive entry rather than inefficient ILEC investment. For example, in order to remain competitive in the Centrex market, ILECs have apparently deployed maximum density outside plant configurations in potential Centrex sites, even though only a small fraction of customers at these locations actually

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[87] See, e.g., American Telephone and Telegraph Company, Docket No. 19129 (Phase II), Phase II Final Decision and Order, 64 FCC2d 1, 49, at ¶ 118 (1977) ("We cannot countenance an approach which would require ratepayers to pay a return to AT&T's investors on capital which to the ratepayers is nonproductive. . . . [E]xcessive investment is properly the responsibility and burden of the investor").

subscribes to Centrex services.[88] Indeed, Economics and Technology, Inc. has demonstrated that such investment continued in certain markets after the demand for Centrex services (relative to PBX) began to decline after 1980.[89] The "stranded" investment in such outside plant is principally or entirely the result of either excessive construction of facilities motivated by some specific marketing goal or simply the result of inaccurate forecasting. It is not due to competition.[90]

Finally, and perhaps most importantly, the overall social costs of guaranteeing ILEC recovery of whatever uneconomic sunk costs they still have are simply outweighed by the social benefits of permitting competition in the local market. As noted, recovering sunk costs from other carriers, especially the ILECs' competitors in the access market, limits the development of competition and its benefits to consumers. If potential entrants know that they will not be able to take advantage of their lower costs, they will be discouraged from entering the local telephone

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[88] See Lee L. Selwyn, Patricia D. Kravtin, and Paul S. Keller, "An Analysis of Outside Plant Provisioning and Utilization Practices of U S WEST Communications in the State of Washington," prepared for the Washington Utilities and Transportation Commission, March, 1990.

[89] See id. Attachment 8.

[90] There are many other possible reasons for unrecovered investment. For example, low plant utilization could well be caused by poor ILEC inventory management. ILECs have historically kept manual rather than computerized databases. ILECs may therefore be adding more loop plant simply because they do not have any idea which loop plant can be used.

business. The resulting loss of competition in the local telephone market would be unacceptably costly and contrary to the intent of the Telecommunications Act of 1996.

B. There Is No Legal Requirement That ILECs Recover Their Historical Costs.[91]

In determining whether a scheme of rate regulation permits a regulated firm adequate compensation, courts examine whether the rates in question "enable [a] company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risk assumed."[92] Under this "end result" test, if a regulatory regime does not deprive the company as a whole of access to capital, then it does not constitute a taking.[93]

The Supreme Court has held that preventing (TWComm only suggests that recovery not be guaranteed) a regulated firm from recovering certain historical costs is not, by itself, impermissible under the Hope standard. In Duquesne the Court reviewed a challenge to a state law which prevented power companies from recovering historical pre-construction investments in subsequently canceled nuclear power plants. The Court found that the state law did not result in a taking because it did not jeopardize the ability of the

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91 This Subsection relates to Section VII.B of the Notice.

92 FPC v. Hope Natural Gas Co., 320 U.S. 591, 605 (1944).

93 See Duquesne Light Co. v. Barasch, 488 U.S. 299, 310 (1989) ("'If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry . . . is at an end.'" (quoting FPC v. Hope Natural Gas Co., 320 U.S. at 602)).

regulated firms to attract capital and compensate investors.[94] Thus, unless the ILECs can demonstrate that an inability to recover their purportedly stranded costs will deny them access to capital markets (and they cannot make such a showing), the FCC is under no obligation in the instant context to permit recovery of "stranded" costs.

Indeed, the ILECs have no entitlement to continue their current profitability. As the D.C. Circuit has explained, nothing in the Fifth Amendment requires that a utility be assured that its stock price will not decrease:

> The Supreme Court has made clear that the FCC has no obligation to maintain the current market value of investors' property. See Hope, 320 U.S. at 601, see also Jersey Cent. Power & Light, 810 F.2d at 1175. That doctrine supports the FCC's decision to establish a rate of return that may not compensate shareholders in such a way that share prices will remain at the same level, ceteris paribus.[95]

C. The FCC's Price Cap Rules Provide ILECs The Opportunity To Recover Historical Costs.[96]

As explained above, there is neither a policy nor a legal reason for ILECs to be guaranteed recovery of stranded costs. However, the current price cap regime gives ILECs a fair opportunity to recover historical costs where competition permits. This regime should remain in place.

The FCC price cap indexes established for the ILECs are based on the historic level of costs allocated to the

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[94] Id.

[95] Illinois Bell v. FCC, 988 F.2d 1254, 1261 (D.C. Cir. 1993).

[96] This Subsection relates to Section VII.B of the Notice.

interstate jurisdiction.[97] Those price ceilings have only been reduced since the creation of the price cap regime as a result of the application of X-Factors, the levels of which the ILECs themselves have been partially permitted to determine. If the Commission retains this regime and allows prices to decline in response to competition (rather than prescription), the ILECs will continue to have an adequate opportunity to recover historical costs.

In an apparent effort to ensure that ILECs recover historical costs and have the flexibility to respond to competition, the Notice discusses a wide range of proposals that, taken together, seem to offer the ILECs both pricing flexibility and flexibility with guaranteed levels of earnings. Such a regulatory scheme would result in little or no local competition with consumers continuing to pay monopoly rents. The Commission must decide whether it will return to rate of return regulation or allow the ILEC the continued risk/reward benefits of price cap regulation; it cannot do both.

As mentioned, TWComm recommends that the Commission continue to restrict pricing flexibility under price caps. While the FCC's price cap scheme inevitably contains an element of rate of return regulation, an explicit return to the latter regime would serve to fully revive the "poisonous

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[97] See Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 at ¶ 230 (1990).

synergy" between market power and cost-based regulation that formed the basis of the AT&T consent decree.[98] The incentive to discriminate and cross-subsidize that this synergy creates is especially destructive when firms are trying to enter the local market and the restrictions on ILEC entry into competitive markets (long distance, manufacturing etc.) are being lifted.

Finally, there is no need to grant the ILECs further pricing flexibility in addition to the substantial flexibility already included under price caps to allow them to recover stranded costs. The price ceilings are high enough to cover the historic cost levels. As explained above, additional pricing flexibility will only serve to guarantee recovery of stranded costs because ILECs can use it to stifle competition.

V. THERE IS NO NEED AT THIS TIME TO REGULATE TERMINATING ACCESS PROVIDED BY CAPS.[99]

In the Notice, the Commission requests comment on whether it should regulate terminating access and so-called "open end" originating minutes (e.g., originating access for 800 service) provided by competitive local exchange carriers.[100] The Commission is apparently concerned that

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98 The term was first coined by the Justice Department's Triennial Review consultant, Peter Huber. See "The Geodesic Network, 1987 Report on Competition in the Telephone Industry," January 1987 at 1.9.

99 This Section relates to Section VII.A.2 of the Notice.

100 See Notice at ¶¶ 277-281.

new entrants may try to charge long distance carriers extremely high rates in these instances.

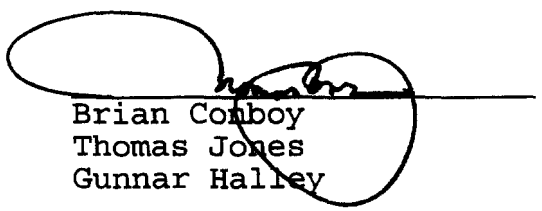
While it is theoretically possible that CLECs might attempt to overcharge for terminating access and for open-end originating minutes, the Commission presents no evidence and TWComm is unaware of any evidence that this has actually taken place. There is therefore no need to establish rules for CLEC terminating access or open-end originating access at this time.

Indeed, the imposition of unnecessary regulations on new entrants would be destructive. Regulation would only add to the significant costs of entry and inhibit further the development of competition. The precedent of such regulation might also be used as the basis for further regulation. It would therefore be far more constructive for the Commission to concentrate on controlling those with a long history of abusing their market power: the ILECs.

VI. CONCLUSION

The Commission should adopt revised rules for interstate access in accordance with these comments.

Respectfully submitted,



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January 29, 1997

APPENDIX

TO THE

COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS, INC.

CC DOCKET NO. 96-262

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
	)	
Treatment of Operator Services Under Price Cap Rules for AT&T	)	CC Docket No. 93-124
	)	
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS, INC.

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requests. Whatever process is ultimately adopted, the criteria should be clearly defined so that each determination does not necessitate all parties engaging in a detailed, expensive and prolonged litigation.

Background
Issues 13, 14a, 14b **The Commission Should Consider The Entire Economic Market In Its Evaluation Of LECs' Market Power In The Provision Of Access Services**

In order to determine whether a firm exerts market power, it is necessary to define the appropriate market within which the firm's power is to be assessed. The NPRM requests comment on the relevant product market and the relevant geographic market for assessing the market power of LECs in their provision of access services. Specifically, the NPRM seeks a model for defining product and geographic markets in access service that can provide definitions that can serve as the "base units for evaluating competition in the access markets."[42]

Although the Commission exercises regulatory oversight only over the LECs' interstate services, it would be a serious mistake to allow these jurisdictional boundaries to constrain analysis of the appropriate economic boundaries of a market. Relevant markets encompass intrastate and interstate services; indeed, it is unlikely that any competitor could survive if, for example, it were permitted to serve only one and not the other. Therefore, although the Commission does not regulate a LEC's

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[42] Id. at para. 116.

intrastate services, it must consider the LEC's provision of such services when it defines and examines markets.[43]

For example, if interstate switched transport service were characterized by high demand elasticity and high supply elasticity, if the same facilities were supporting intrastate message toll service, and furthermore, if the intrastate MTS market were not yet competitive, the LEC would have a unique and formidable advantage over any other facilities-based provider by virtue of its ability to share and to shift costs for the interstate switched transport with and to the intrastate toll market. There is no "interstate market" per se, and a narrow examination of an "interstate market" could lead one to the erroneous conclusion that the overall market for the LECs' services faces effective competition.

Of course, there may be examples where a given product market is competitive in both the interstate and intrastate jurisdictions. At some point in the future, a LEC's provision of special access services may be such that it is competitive within a particular geographic area, in both the intrastate and interstate levels. Indeed, it is probable that if competitive access providers ("CAPs") have constructed competitive networks for providing dedicated access between customer premises and interexchange carriers' points of presence and between LECs' central offices and IXCs' POPs, that such facilities will pose

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[43] The Commission has noted the relevance of state regulation on the Commission's level of interstate oversight. See Id. at para. 109.

competition for both the LECs' interstate and intrastate special access services.

Issue 13 The Definition Of The Relevant Product Market Should Take Into Account The Substantial Common Costs That Support Differing Telecommunications Services

The relative presence or absence of shared costs among products or among geographic areas directly and substantially influences the possibility for LECs to exert market power, particularly where the products or geographic areas encompass both competitive and noncompetitive elements. The more extensive the joint or shared costs as between a competitive and a monopoly service offered by an integrated, dominant LEC, the more difficult it will be for a competitor to overcome the substantial supply advantage enjoyed by the LEC.

Indeed, the presence of large shared (and often relatively fixed) costs argues for the treatment of such underlying facilities as "essential," permitting the competitor to access them on the same favorable terms as the LEC itself enjoys with respect to its competitive services. For example, a pole line is capable of carrying a broad range of distribution facilities, including dial tone, private line, special access, broadband, and video. From the LEC's perspective, adding video distribution cable facilities to an existing pole line imposes minimal incremental cost, because it is able to share the costs of the pole with its preexisting conventional (voice grade) services. Since it is not economically feasible for a new

entrant to duplicate the in-place poles, it has very little choice but to rent space on LEC and other utility poles for purposes of running its distribution plant. Unless the LEC charges the new entrant the same (marginal cost) price that the LEC itself incurs when it adds its own video dial tone cables to an existing pole, it gains an overwhelming economic advantage over rival cable TV operators.[44]

If, within a given geographic area, a LEC were to offer numerous competitive services and no monopoly services (a scenario that is many years off), the fact that the diverse services might share substantial common costs would not be troubling. The scenario that merits particular scrutiny — and the one that is likely to prevail for the foreseeable future — is one in which the products and/or geographic areas encompass a combination of competitive and noncompetitive services. The presence of a high percentage of common costs creates a strong incentive for LECs to shift such costs from the competitive market to the noncompetitive one. That is, although an individual market may appear intensely competitive, if an adjacent product or geographic market is not competitive, the appearance of competitiveness may be misleading and illusory.

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[44] An alternative, albeit less economically desirable, approach would be for the LEC to impute to itself whatever price it imposes upon its competitors for access to poles. But any arrangement whereby the LEC can use poles for its own competitive services at little or no marginal cost, while imposing substantial pole attachment costs upon its competitors, is fundamentally anticompetitive and at odds with the Commission's goals of achieving a level playing field that is truly conducive to fair and open competitive entry.

The presence of alternative suppliers of switched transport in the Manhattan area for example, may suggest that the product is competitive in the Manhattan market. However, two additional levels of examination are required before there can be a determination that the product is competitive in the Manhattan market. First, if there is no competition for intraLATA long-distance services (likely caused in part by the lack of 1+ presubscription), the competition for interstate switched transport may not be sufficiently robust to constrain the LEC's market power, because the LEC can easily shift common costs to the (noncompetitive) message toll service market. Second, there may be substantial competitive activity in lower Manhattan for switched transport, but if the competition is not effective throughout the Manhattan market, the service should not be declared competitive.

Alternatively, the LEC should be required to price switched transport identically throughout the given geographic area characterized by shared costs. Here, the LEC is forced to offer competitively-priced services even in those segments of the defined market in which no competition is yet to be found. The LEC is thus precluded from cross-subsidizing the competitive portions of the market with higher prices charged in the noncompetitive portions, and further is required to bring competitive price levels to all customers, whether or not any individual customer actually confronts a competitive alternative. If a LEC is willing to price its services under this "market-wide" arrangement, then the entire scope of the area within which

the competitive price would be offered could be treated as a single geographic market.[45]

The NPRM proposes to define the relevant product market using existing definitions of current service categories within each access service basket. The NPRM seeks comments on using these access service definitions for defining the relevant markets and, furthermore, indicates that any alternative proposals should be supported.[46] TW Comm concurs with the NPRM that the single product market which was defined for the IXCs' interstate services is not the appropriate product market for LEC services[47] because such a market would be overly broad.

The existing price cap service categories generally represent an acceptable foundation for assessing the market power of LECs. Competition may arrive in some product markets earlier than it does in others, and ultimately, it may be appropriate to grant pricing flexibility in certain markets before granting

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[45] The foregoing discussion assumes that the LEC would not be capable of cross-subsidizing the defined competitive market (Manhattan in this example) with higher prices imposed in other noncompetitive markets (e.g., the Bronx). It assumes that joint and common costs exist within a single defined market (Manhattan) but do not exist across separate market areas. Overhead costs vary directly with the scale of a LEC's operations and thus they should be allocated proportionally among the relevant markets. The LEC should be allowed to either (1) demonstrate that such a proportional allocation has been made, or (2) alternatively, if the LEC contends that such an allocation of the overhead costs cannot be made among the markets in question, the LEC should not be allowed to divide the market.

[46] LEC Pricing Flexibility NPRM at para. 118-119.

[47] Id. at para. 117.

pricing flexibility in other product markets.[48] Although the existing service categories are generally useful, there are some particular problems with using them that should be addressed:

- The common line basket includes the end user common line charge and the carrier common line charge, rate elements associated with the non-traffic-sensitive costs of local loops. In assessing whether the common line basket is competitive, it is essential to assess the level of competition that has emerged in the local exchange market, which necessarily requires an evaluation of intrastate services.

- The traffic-sensitive basket of services[49] may pose problems if the geographic markets are not properly defined or if the Commission prematurely classifies an individual service as competitive. For example, local switching is used for numerous intrastate and interstate services such as custom calling features, local usage, message toll service and switched access. If the Commission defines a geographic market that is too narrow, then anticompetitive problems with this product market designation may ensue because the LEC could shift shared costs from those isolated instances where certain services may face emerging or actual competition to other parts of its market where there is no competitive activity. Assuming the Commission considers a sufficiently broad market (and considers both intrastate and interstate services), and assuming further that the appropriate criteria are applied to a particular product market, then the services in the traffic-sensitive basket can serve as useful designations for product markets.

- The use of the services in the trunking basket as product markets raises several concerns.[50] The major

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[48] As a fundamental matter, however, as stated previously, TW Comm is extremely skeptical of the need to make such an assessment at any time in the foreseeable future.

[49] This basket includes four service categories: (1) local switching; (2) information; (3) data base access; and (4) billing name and address.

[50] This basket includes seven service categories: (1) voice grade flat rate transport, voice grade special access, WATS, metallic, and telegraph; (2) audio and video; (3) high capacity and digital data services (this category includes

(continued...)

concern regards the interconnection charge which is a meaningless "service" because the residual interconnection charge ("RIC") is not a product that a consumer purchases but rather is a rate element that was created solely as a means for recovering the LEC's residual revenue requirement. For example, the tandem-switch service is a meaningful product because it is a service that may be purchased and used without other services. However, this product as well as the tandem signalling service share costs with intrastate MTS services. Until such time as intrastate message toll service is competitive, it would be inappropriate to grant competitive status to tandem-switched transport service or to tandem-switched signalling. Furthermore, the interoffice component of trunking may face effective competition before the local distribution channel does, in part as a result of the Commission's orders regarding collocation for special access and switched transport services, and, therefore, it may be appropriate to consider these two elements as separate products.

In summary, the use of the existing services in the four price cap baskets, subject to the concerns discussed above, could serve as appropriate definitions for the LECs' product markets.[51] In its evaluation of the competitiveness of individual products, the Commission must consider the product's competitiveness within a sufficiently large geographic market (including the intrastate and interstate jurisdiction). These

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[50](...continued)
two sub-categories: DS1 special access and DS1 flat-rate transport and secondly DS3 special access and DS3 flat-rate transport); (4) wide band data and wide band analog; (5) tandem-switch transport; (6) the interconnection charge; and (7) signalling for tandem switching.

[51] The fourth basket is the interexchange basket (for intraLATA, interstate traffic). There are also billing rate elements that are associated with the specific costs and functions of the LECs' interstate services.

levels of scrutiny are necessary to ensure that the LEC's pervasive common costs do not afford it any unfair advantage in the marketplace.

Issues 14a, 14b The Relevant Geographic Market Should Be Sufficiently Large To Prevent The Shifting Of Common Costs Between Competitive and Non-Competitive Markets

The NPRM tentatively proposes to use the density zones that the LECs developed for the provision of expanded interconnection service as the geographic market for access services.[52] The NPRM states that the relevant geographic market should be sufficiently narrow to encompass only competing access services for the same set of customers, yet be sufficiently broad to be administratively workable.

The NPRM seeks comments on the use of density-based pricing zones, and also on whether other boundaries for markets should be adopted (e.g., LATAs, Metropolitan Statistical Areas, or wire centers). As noted by the FCC, it would not be administratively feasible to use the wire center as the basis of the geographic market because there would be thousands of individual markets. TW Comm opposes the use of wire centers for this reason and also because a wire-center based market definition would create countless opportunities for shifting common costs from wire centers characterized by the entrance of potential competitors to wire centers with minimal competitive

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[52] LEC Pricing Flexibility NPRM at para. 120.

activity.

The Commission also should not adopt density-based pricing zones as the relevant geographic market for assessing competition and granting regulatory relief. There are three density zones for special access and switched transport. Areas with the highest traffic density are designated as Zone 1. As it has been recognized,[53] the pricing zones for trunking have developed in a "checkerboard" fashion rather than in contiguous geographic areas. The fact that wire centers in the least competitive market would abut wire centers in more competitive markets creates a significant opportunity for the LEC to shift shared costs among wire centers to pursue unfairly its competitive strategies. Furthermore, as appropriately noted in the NPRM, for example, the pricing zones that exist today are based upon the amounts of trunking traffic, which may not be useful for defining services in the traffic sensitive, common line, and interexchange baskets.[54]

LATAs may be an appropriate geographic market, provided that all customers within the LATA were presented with competitive alternatives; i.e., provided that the LATA for which an assessment of competitiveness was being made did not include geographic "pockets" of monopoly service. Alternatively, TW Comm would support the use of LATAs as the boundaries of relevant geographic markets even where the LATAs included some less

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[53] Id. at para. 124.

[54] Id. at para. 124.

competitive subregions if LECs were required to set prices uniformly throughout each LATA. This condition is necessary to ensure that in those instances where a LATA might encompass mainly competitive areas, but also included geographic pockets where customers had no meaningful competitive alternatives, LECs would not be able to shift common costs from the competitive areas within the LATA to the noncompetitive areas within the LATA. This proposed mechanism responds directly to one of the questions posed in Issue 14b.[55] If prices differed, it would suggest that some of the area was not competitive and the customers in the non-competitive pockets would be at risk of bearing an unfair share of the common costs.

Because of the substantial amount of costs that are shared among geographic areas and among the LECs' telecommunications products, the Commission should guard against balkanization of LECs' markets. Allowing piecemeal pricing flexibility will create enormous incentives to shift the recovery of common costs from geographic markets that face competition to those that do not and from products that face competition to those that do not. Only if there are significant differences in the "non-common" costs that a LEC can demonstrate should the Commission permit geographic de-averaging.

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[55] The Commission asks whether pricing flexibility in an entire study area should be permitted even if a demonstration of competitive conditions has been made only in a portion of the study area. Id. at para. 123.

Background
Issues 15a - 15e Criteria To Be Utilized in Evaluating a LEC's Market Power

The NPRM seeks comment on, among other things, the proposal to "rely more heavily on market forces to achieve [its] public policy goals."[56] TW Comm urges the Commission to rely on market forces only if and when the market forces are such that they effectively discipline the prices and behavior of the incumbent LECs. The NPRM draws an analogy between the analytical framework the Commission used to streamline AT&T's services with one that it proposes be used for relaxing regulation of the LECs' price cap services.[57] The standards used by the Commission for declaring AT&T nondominant,[58] and the standards used during the last decade for granting AT&T gradual pricing flexibility[59] are the appropriate economic standards for assessing whether a market is sufficiently competitive to warrant the relaxation of regulatory oversight. However, the LEC market is many years away from satisfying these standards. Thus, although the parameters that the Commission identifies are the appropriate measures for

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[56] In re Price Cap Performance Review for Local Exchange Carriers, Order on Motion for Extension of Time, CC Docket No. 94-1, FCC-2340, para. 1 (November 13, 1995).

[57] LEC Pricing Flexibility NPRM at para. 128.

[58] In re Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, FCC 95-427 (October 23, 1995) (hereinafter "AT&T Reclassification Order").

[59] See, e.g., In re Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd 5880 (1991) (hereinafter "Interexchange Order"); In re Revisions to Price Cap Rules for AT&T Corp, Report and Order, 10 FCC Rcd 3009 (1995) (hereinafter "Commercial Services Order").

evaluating the local telecommunications market, any application of these parameters would be extremely premature.[60]

Today's relationship of AT&T to the long-distance market is fundamentally different from that of the LECs' relationship to the access services market for numerous reasons, some of which are:

- AT&T does not control bottleneck network capabilities but the incumbent LECs do.
- From 1984 to 1994, AT&T's market share, in terms of revenues and minutes, declined from approximately 90 percent to 55.2 and 58.6 percent, respectively.[61] LECs still control 99% of the access services market.
- Interstate and intrastate access charge structures have been created and implemented, giving AT&T's competitors "equal access" to the local network. LECs' competitors do not yet have "equal access" to the local network.
- The portability of 800 service numbers has been designed and implemented. Local numbers are not yet portable.
- There are no legal and economic barriers to serving the long-distance market, yet there are substantial barriers to serving the local market.

Generally, sweeping technical and regulatory changes (including the largest corporate reorganization in U.S. history and numerous competitive rulemakings by the Commission) occurred

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[60] To discuss applying these criteria to today's local telecommunications markets would be akin to placing a thermometer into ice water to see if the water was ready for making tea.

[61] AT&T Reclassification Order at para. 67.

over a span of almost two decades[62] before the Commission lessened its oversight of AT&T. A combination of affirmative regulatory changes and evidence of actual competition preceded the Commission's relaxation of regulatory constraints on AT&T.

Although AT&T and LECs have both been regulated by a system of price caps, and although AT&T and LECs both provide telecommunications services, the similarities of their positions in the markets they serve soon end. We are many years away from being able to meaningfully assess whether it is appropriate to grant substantial pricing flexibility to the LECs. However, despite these fundamental differences in the status of the long-distance and local markets, with the caveats discussed below, the criteria that the Commission has used to measure AT&T's market power in the past are certainly applicable to the Commission's evaluation in the future of the LECs' market power.

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[62] The initial efforts to introduce competition in the long-distance market could be pegged to any of several events. In the mid-1970s, MCI introduced its "Execunet" service, which was the first alternative to the Bell System's switched interexchange message telecommunications service. The Commission initially determined that MCI was not authorized to provide its "Execunet" service, finding that it was only authorized to provide private line service. See In re MCI Telecommunications Corp. Decision, 60 FCC 2d 25 (1976). However, that finding was overturned by the D.C. Court of Appeals. See MCI Telecommunications Corp. v. FCC, 561 F.2d. 365 (D.C. Cir. 1977) cert. denied 434 U.S. 1040 (1978). In 1978, the Commission established a rulemaking that ultimately led to the creation of access charges for interexchange services and equal access to local exchange networks for all interexchange carriers.

Issues 15a and 15b Demand Responsiveness And Supply Responsiveness Should Be Among The Criteria Used By The Commission To Evaluate The Competitiveness Of The Local Market

It is clear that demand and supply elasticity are certainly appropriate criteria for evaluating the potential competitiveness of a market. However, in considering demand elasticity, the Commission should recognize and account for the fact that, unlike in the interstate long-distance market where customers switched among competing providers, customers in the local market may simply supplement the service offered by the incumbent. If customers are not migrating away from the incumbent but choose simply to add redundant service, this fact should be reflected in any analysis of the market's competitiveness.

Barriers to entry directly and substantially influence supply elasticity: substantial capacity held by carriers is immaterial if barriers such as lack of true number portability and lack of network unbundling persist. Therefore, in evaluating supply elasticity, the Commission should critically and comprehensively examine the degree to which a rigorous "competitive checklist" has been satisfied.[63]

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[63] As stated earlier, satisfying the competitive checklist does not necessarily transform a noncompetitive market into a competitive one. It is an essential step for enabling competition to evolve, but the fact that barriers to entry have been removed does not in and of itself render a market competitive.